

United States Court of Appeals
For the Ninth Circuit

ARTHUR L. LAWRENCE and ALMA P. LAWRENCE
Petitioners-Appellants

VS.

COMMISSIONER OF INTERNAL REVENUE
Respondent-Appellee

ON PETITION TO REVIEW A DECISION OF THE TAX COURT
OF THE UNITED STATES

REPLY BRIEF OF APPELLANTS

LITTLE, LESOURD, PALMER, SCOTT & SLEMMONS
BROCKMAN ADAMS
MAX D. CRITTENDEN

Attorneys for Appellants.

15th Floor, Hoge Building,
Seattle 4, Washington.

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COMMISSIONER OF INTERNAL REVENUE,
 Respondent-Appellee.

} No. 15532

ON PETITION TO REVIEW A DECISION OF THE TAX COURT
OF THE UNITED STATES

REPLY BRIEF OF APPELLANTS

The brief for the Government in this court is a further example of the respondent-commissioners' ever-increasing technical interpretation of the words "omit," "income," "gross income," and his attempt by means of a technical application of the method of reporting and computing taxable income to extend the statute of limitations to five years in as many cases as possible. Logically it would seem that Congress' original intention in providing a 5-year statute of limitations for "omission" was to give the Commissioner additional time to discover items which could not be ascertained from an examination of the face of the return. This position has obviously been abandoned by the Commissioner, since at no point does the respondent-commissioner argue that appellants' receipts were not clearly revealed or their method of handling and the taxpayers' legal position completely and fully set

forth. Appellants' opening brief did not discuss at length certain appellate decisions in that appellants did not know what technical defenses the respondent-commissioner would present to this court. Upon examination of respondent's brief it is submitted that every issue raised by respondent-commissioner has previously been decided against respondent in the appellate courts.

I.

There Has Been No Omission of Gross Income Within the Meaning of §275(c) Internal Revenue Code of 1939

The respondent in his brief (Resp. Br. p. 6) argues that the item of income here in question was not included in taxpayers' taxable income as reflected in item 6, page 1, of the return. The respondent then argues (Resp. Br. 7) that an exclusion from "reportable income" is the same as "omits from gross income." This precise point was raised by Commissioner in *Davis v. Hightower*, 230 F.(2d) 549 (5th Cir. 1956) This case involved whether or not a specific item of income was to be treated as a capital gain or ordinary income. The Commissioner urged that since the taxpayer had treated this income as a capital gain, the amounts excluded by the taxpayer did not appear in item 6 on page 1 of the return and did not appear on page 2 in the summary from separate Schedule D and therefore was an omission from gross income. The appellate court examined the income tax return and determined that there is no one place in the return to include a figure which might be called "gross income" and, therefore, the taxpayer, in entering the amounts

which he considered as capital gain on Schedule D, had reported his "gross income." The court then went on to point out the unfair and illogical interpretation which the Commissioner's construction of the statute would establish:

"[2] The only way in which the taxpayer here could satisfy the government's requirement that he state his 'gross income' in a way to permit a tax computation of the amount the government claims is due, would be for him to abandon his claim that he was entitled to capital gains treatment of the sales in question. No such penalty was intended by Congress in extending the statutory period to five years in case of substantial omission. It cannot be thought that if a taxpayer accurately fills in every blank space provided for his use in the income tax form, giving every 'gross' or maximum figure called for, and arrives at an incorrect computation of the tax only by reason of a difference between him and the Commissioner as to the legal construction to be applied to a disclosed transaction, the use of a smaller figure than that ultimately found to be correct in one stage of the computation amounts to an omission from 'gross income' of the difference between the correct and incorrect item."

This same position now being urged by Commissioner in the case at bar would effectively prevent the taxpayer from invoking the jurisdiction of the Tax Court, which was established to prevent oppression of the taxpayers by allowing them to litigate before paying when aggrieved by questionable application of the tax law. The position urged by respondent-commissioner would mean that taxpayers would be forced to

include all items in their computation of taxable income (whether excludable or not) and then sue for refund of such amounts or automatically place themselves in the position of establishing a five-year statute of limitations. There is no indication that Congress ever intended that taxpayers should be required to submit to a five-year statute of limitations on matters involving exclusions from taxable income in order to invoke the jurisdiction of the Tax Court, which Congress specifically created to allow taxpayers to litigate questionable theories of taxation first before being subjected to assessment.

Commissioner next argues that this case is distinguishable from *Slaff v. Commissioner*, 220 F.(2d) 65 (9th Cir. 1955) on the basis that taxpayers may have reported the items received but that they were not reported as Mr. Slaff did in a box entitled "income." If the argument of the respondent-commissioner is that the taxpayer must report the item as taxable income and include it in his final summarization of taxable income, then this is the same argument he makes in his brief (Resp. Br. pp. 6-7) which is completely answered by the reasoning set forth in *Davis v. Hightower*, *supra*. If the respondent-commissioner is arguing that there is a factual distinction between the *Slaff* and *Lawrence* returns because the *Lawrence* returns contain the reporting and computing of gross income on a separate schedule, then the respondent-commissioner is arguing a distinction on which said respondent has been previously overruled by the Third Circuit in *Deakman-Wells Co., Inc. v. Commissioner*, 213 F.(2d) 884 (3rd Cir. 1954).

Respondent-commissioner cites the case of *O'Bryan v. Commissioner*, 148 F.(2d) 456 (9th Cir. 1945). This was one of the early cases litigated by the commissioner when the commissioner was litigating those cases wherein there had not been a full disclosure and commissioner had a logical basis for arguing that completely omitted or misleading reporting of gross income should entitle the commissioner to a 5-year statute of limitations in which to discover such omissions. The reporting in *O'Bryan v. Commissioner, supra*, was misleading and the case was not decided on the basis of full disclosure, since the Tax Court in the *O'Bryan v. Commissioner*, 1 T.C. 1137, found that in this case there had been no full disclosure. The distinction between the *O'Bryan v. Commissioner, supra*, case and the cases of Mr. Lawrence and Mr. Slaff is that both Lawrence and Slaff reported their respective "income" in the proper manner on their returns and neither omitted anything.

It is true that the Third Circuit Decisions of *Uptegrove Lumber Co. v. Commissioner*, 204 F.(2d) 570 (3rd Cir. 1953) and *Deakman-Wells Co., Inc. v. Commissioner, supra*, involved overstatement of deductions from gross income which thereby resulted in the computation of "adjusted gross income" being incorrect, but certainly the Commissioner does not urge that there is a valid distinction between taking an improper deduction because of a faulty legal theory and taking an improper exclusion because of a faulty legal theory when both are clearly stated on the return.

The Sixth Circuit decisions of *Ewald v. Commis-*

sioner, 141 F.(2d) 750 (6th Cir. 1944), and *Reis v. Commissioner*, 142 F.(2d) 900 (6th Cir. 1944) are not applicable to the case at bar in that there was an admitted "omission" in *Ewald v. Commr., supra*, and the taxpayer was argueing whether the statute applied to intentional as well as negligent omissions. The distinction between *Ewald v. Comm.*, *supra*, and the case at bar is well set forth in *Uptegrove Lumber Co. v. Commissioner*, 204 F.(2d) 570 (3rd Cir. 1953) in the following language:

"Beyond this, we have found no decision of a Court of Appeals which has considered this problem. The Commissioner suggests that his position is supported by such cases as *Ewald v. Commissioner*, 6 Cir., 1944, 141 F.(2d) 750; *Ketcham v. Commissioner*, 2 Cir., 1944, 142 F.(2d) 996, and *O'Bryan v. Commissioner*, 9 Cir., 1945, 148 F.(2d) 456. We do not agree. These cases all involved failures to enter certain items of gain in the gross income sections of returns. Each taxpayer relied upon the fact that somewhere else in his return, or in some statement attached to it, he had revealed the existence of the item in question though he did not report it as gain taxable to himself. On this basis it was arguable that these cases did not involve the mischief of effective concealment by non-disclosure which the extended limitation period of Section 275(c) was designed to offset. For taxpayers having revealed the omission when they filed their returns, there would be no reason of policy for allowing an extra two years for the Collector to act upon those omissions. But the courts could not reach these policy considerations because the applicability of the language of the statute, 'omits from gross income,' to the given facts was so clear.

There was no relevant ambiguity in the statute to warrant the consideration of its purpose in order to discover its meaning. Thus, the cited cases do not help us here.”

Sixth Circuit decisions of *Carew v. Commissioner*, 215 F.(2d) 58 (6th Cir. 1954) and *Colony Inc. v. Commissioner*, 244 F.(2d) 75 (6th Cir. 1957) petition for cert. filed July 22, 1957, are not helpful in that *Carew v. Comm.* involved an admitted omission and *Colony Inc. v. Comm.* was affirmed on the basis of the earlier 6th Circuit decisions, without an analysis of the recent Circuit Court Decisions.

The Second Circuit decision of *Ketcham v. Commissioner*, 142 F.(2d) 996 (2nd Cir. 1944) again is a case involving a question of whether there had been a full disclosure or whether the taxpayer had misled the Commissioner.

II.

Legislative History

Appellants' argument (App. Br. pp. 14-18) on legislative history is based upon the meaning of the word “omit,” not on negligence or intention of taxpayer. Respondent does not meet appellants' argument on the meaning of the word “omit.”

III.

Effect of Section 6501(e)(1)(A) of Internal Revenue Code of 1954

The retroactive effect of remedial legislation upon matters which have been extensively litigated in the courts is very difficult to determine. Taxpayers submit that said legislation will have its true application to

situations occurring in the future, but wish to point out that the respondent-commissioner's argument that this was a change from existing law and therefore the existing law must have been in his favor (Resp. Br. 16-17) has been rejected by the Court of Appeals for the Fifth Circuit in *Davis v. Hightower*, 230 F.(2d) 549 (5th Cir. 1956). The court summarizes the effect of Section 6501 in the following language:

"To this legislative history is now added the amendment contained in the 1954 Internal Revenue Code, under the terms of which it is now clear that the inclusion of the statement made by appellee in his return here would be sufficient to prevent application of the five-year statute. In view of the confusion as to the meaning of the statute prior to the adoption of the 1954 Code, we think it plain that the new language was enacted to clarify the existing law."

IV.

Conclusion

Taxpayers submit that respondent-commissioner in his brief has not urged upon this court a single new argument that has not been previously decided against respondent in one or the other of the Courts of Appeal, and further that Commissioner has not shown a logical or equitable reason for applying the five-year statute of limitations in this case.

Respectfully submitted,

LITTLE, LESOURD, PALMER, SCOTT & SLEMMONS

BROCKMAN ADAMS

MAX D. CRITTENDEN

Attorneys for Appellants.